Office-Supreme Court, U.
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JUN 23 1950
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IN THE

Supreme Court of the United States

OCTOBER TERM 1949.

No. 143

MARINE MAINTENANCE CORPORATION, Debtor,
Petitioner,

AGAINST

EDWARD R. McGLYNN, as Trustee in proceedings for reorganization of debtor,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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Respondent.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable, the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Marine Maintenance Corporation, referred to herein as the debtor, respectfully prays for a writ of certiorari to review a judgment of the United States Court of Appeals for the Third Circuit, entered March 28, 1950, which reversed an order of the United States District Court for the District of New Jersey.

Summary Statement of the Matter Involved.

On February 23, 1943 Marine Maintenance Corporation filed a petition under Chapter X of the Bankruptcy

Act in the United States District Court for the District of New Jersey. The respondent herein, Edward R. McGlynn, was appointed Trustee together with an officer of the debtor who was appointed co-trustee but who resigned shortly thereafter. The respondent continued as sole Trustee, but at no time was the debtor engaged in business operations during the course of the reorganization proceeding. This was for the reason that the United States of America, acting through the United States Maritime Commission, had, on February 18, 1943, condemned and seized all the real and personal property of the debtor which consisted of a shipyard and its appurtenances at Bayonne, New Jersey.

Prior to the condemnation of its properties and the inevitable petition for reorganization which followed five days later, Marine Maintenance Corporation was busily engaged in the building, repairing and arming of merchant vessels for wartime purposes of the United States and its allies. Contracts had been entered into with the Maritime Commission and its supplementary agency, the War Shipping Administration. One contract provided for the construction of coastal tankers, and another was concerned with the repairing and defensing of vessels owned or operated by the United States. In addition, Marine Maintenance Corporation had a full schedule of repair and conversion work under way for private owners operating under wartime controls.

Such activities had sprung almost full grown from the advent of the war, transforming a quiet shipyard with a few score personnel into a round-the-clock beehive of industry employing several thousands of workers. This was the situation in January and February, 1943 when the United States Maritime Commission set in

motion the machinery of events which was to run varied and devious courses, in the Courts[1] and in the Congress.[2]

Under the terms of the contract for the repairing and arming of vessels, the Maritime Commission was to pay Marine Maintenance Corporation on a cost-plus basis, all invoices being submitted to the Commission's resident auditors for approval before presentation for payment. In January 1943, the Maritime Commission took exception to numerous invoices submitted for approval on the ground that they contained items of reimbursement unwarranted by the contracts or by existing facts. Accusations and investigation followed, resulting in the indictment of Marine Maintenance Corporation and two of its officers on January 26, 1943.[3] In February, the shipyard was seized and Marine Maintenance Corporation was ousted from possession[4] its properties being turned over to a new operator selected by the Commission.[5]

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1. A history of the instant matter and of concomitant proceedings, not involved in the present appeal, may be found in the opinions of the Court of Appeals for the Third Circuit in the following cases: *United States* v. *Michener*, 152 Fed. (2d) 880; *Kicinski* v. *Constable Hook Shipyard, Inc.*, 168 Fed. (2d) 404.

2. A Subcommittee on Production in Shipbuilding Plants of the Committee on the Merchant Marine and Fisheries, House of Representatives, conducted hearings in 1944 in the matter of Investigation of East Coast Shipyards, Inc. (the Company placed in possession of the debtor's properties by the Maritime Commission after the debtor was ousted), and rendered Report No. 2075, 78th Congress 2d Session, Union Calendar No. 695, as a result of which the debtor's properties were turned back to the Trustee in 1945.

3. The indictment was brought under Section 35(A) of U. S. Criminal Code, 18 United States Code Annotated, 80.

4. For the findings and recommendation of Congress in this respect and with regard to the return of the shipyard to the debtor, see Interim Report, No. 2075, 78th Congress, 2d Session, Committee on the Merchant Marine and Fisheries, House of Representatives.

5. After a trial lasting through the Summer of 1943, a directed verdict of acquittal was rendered for Marine Maintenance Corporation; its president was acquitted, and its treasurer was convicted. The conviction was set aside on appeal (*United States* v. *Michener*, 152 Fed. 2d 880), and the indictment was eventually *nolle prossed*. Similarly, a civil action brought by the Maritime Commission, to recover alleged overcharges and penalties under the applicable statute (False Claims Statute, 31 U. S. C. A. 231 *et seq.*), was compromised by the payment to the debtor of approximately twenty-five percentum on outstanding balances.

At the time of the happening of these events, substantial payments were due and owing to Marine Maintenance Corporation under the terms of its contracts with the Maritime Commission. These payments were suspended, and the filing of the petition under Chapter X followed promptly. The present Trustee was appointed and the matter of the reorganization proceeding was under way.

The unquestioned and particular function of the Trustee was to protect the assets of the debtor. For the criminal proceeding and the civil action herein described special counsel were appointed. No operations of the debtor were possible as it was out of possession of its properties. The matter was one generally of settling accounts.

In March 1945, the debtor's real and personal properties were returned by the Maritime Commission. The consideration paid by the Government to the debtor for the use and occupation of the said properties for the period February 1943 to March 1945, was the vesting in the debtor of title to all of the improvements placed on the real property by the Maritime Commission and the payment to the debtor of the sum of $845,000 in cash. The said money was not deposited with the Clerk of the District Court until 1947.

On June 26, 1947 a plan of reorganization of the debtor was confirmed in the District Court under the terms of which plan all creditors were paid in full out of the funds deposited with the Court for the use and occupation of the shipyard. On August 29, 1947, the Trustee filed his final accounting, dated August 27, 1947. Thereafter, following the consummation of the plan of reorganization, petitions for allowances of various attorneys, including the Trustee's petition, were filed.

All petitions for allowances were referred to a Referee in Bankruptcy who conducted hearings thereon and filed a report with the District Court. As to the Trustee's account, hearings were held by the District Judge and

testimony was taken with reference to the payment by the Trustee of various amounts of money belonging to the debtor, which payments had been made during the period of the trusteeship, and which came to light only with the filing of the Trustee's account. In opposition to the allowance of certain items of alleged expense incurred by the Trustee, the debtor filed exceptions dated September 12, 1947 to the Trustee's final account. The two exceptions which are the subject matter of this petition read as follows (R. 116a):

a) In that it (Trustee's account) includes items of expense and special disbursements totaling approximately $7,000 received by William J. Manning from the Trustee without authorization and for which no proper accounting has been rendered.

b) In that it includes items of expense paid to Alfred M. Greenfield for rent of premises to Marine Maintenance Corporation amounting to approximately $1,700, which rentals were paid without authorization and which were not required for the proper administration of the estate.

In addition to the two foregoing exceptions, the District Judge conducted hearings on all exceptions taken by the debtor to the Trustee's account. On January 5, 1949, the District Judge filed a memorandum, and caused to be entered an *ex parte* order sustaining exception "a)" above, to the extent of $1,340.08 and exception "b)" above, to the extent of $1,725.00, and dismissing all other exceptions taken by the debtor (R. 123a-129a). Appeals were taken in the Court below by the Trustee from the order imposing the two named surcharges, and by the debtor from the order denying the other exceptions. It is

from the judgment of the Court below setting aside the surcharges that the present relief is sought.[6] (Appendix, pp. 29, 30.)

The Allowance to the Trustee.

During the course of the reorganization proceeding the Trustee was granted by the District Judge an interim allowance of $15,000. After the confirmation of the plan and filing of petitions for allowances, the Trustee was granted an additional allowance of $10,000, from which, by order of the District Court, was to be deducted the sum of $3,065.08 as the aggregate of the surcharges based upon exceptions "a)" and "b)" (above) taken to the Trustee's account by the debtor. From an order of January 5, 1949, amending an order of December 15, 1948, and providing for the deduction of $3,065.08 as surcharges from the final allowance of $10,000 to the Trustee, the Trustee appealed to the United States Court of Appeals for the Third Circuit. The said order of January 5, 1949 of the District Court was reversed on appeal.

The Testimony Before the District Court.

A. *As to the Manning Surcharge.*

The first surcharge of $1,340.08 related to payments out of trust funds of certain monies made by the Trustee to one William J. Manning, who was a bookkeeper employed by the Trustee for the purpose of auditing the accounts of the debtor. During the course of the hearings before the District Court in the matter of the Trustee's final account, it appeared that the said bookkeeper had

6. The Trustee also appealed from that part of the order which fixed his allowance at $10,000. The Court below did not interfere with this award. The Trustee had received an interim allowance of $15,000, making a total of $25,000.

an arrangement with the Trustee whereby, in addition to his weekly salary, Manning received reimbursements for expenses allegedly incurred in the auditing of accounts. These expenses were presented each week to the Trustee in the form of hand-written figures inscribed in dollar values on nondescript slips of paper. In return therefor, the Trustee issued a check each week to Manning. In the particulars furnished by the debtor to the Trustee, after an examination by the debtor's representatives of the Trustee's accounts, and in the testimony presented by the debtor to the District Court, it was shown that Manning, for a period of almost two years, had inserted in these weekly vouchers various items which could in no way be supported as charges against the Trustee or the debtor. It was demonstrated in fact, without contradiction, that the so-called expenses were a fraud on the estate, having their being in an obvious scheme of padding an alleged expense account by a five-day distribution of dollars and cents invariably adding up to a weekly total of $40 or a lesser round sum. It was the Trustee's testimony on this point that "If he (Manning) fooled me, he fooled me" (R. 332a).

As a result of this unwarranted squandering of trust money, the District Judge found that a surcharge in the amount of $1,340.08 should be made against the Trustee. The Court was most liberal. The record justifies a surcharge of much more substantial propostion. Yet it was the apparent intention of the Court to treat the Trustee as lightly as possible, the Court taking the position in making a minimum surcharge, that it did not want to lend its approval to what it euphemistically called a "bad accounting practice".

On appeal, the Court below reversed the order fixing this surcharge although it felt that the Trustee's "lack of method * * * was slipshod and deserving of censure".

B. *As to the Rent Surcharge.*

As to the second surcharge of $1,725.00, the Trustee's account filed August 29, 1947 showed that the Trustee had, for the period April 1944 to December 1946, paid the landlord of his law office trust monies in the amount of $50 each month, a policy which effected a reduction *pro tanto* of the Trustee's own monthly rental for his private office.

The District Judge in his memorandum opinion filed December 15, 1948 took the position that the expenditure for rent should not have been made by the Trustee without his first acquainting the Court with the necessity of making it and obtaining the Court's approval therefor. The Court of Appeals did not feel that this surcharge was justified and reversed the applicable order of the District Court.

Opinion Below.

The opinion of the Court of Appeals for the Third Circuit is reported in 181 Fed. (2d) 119 and Appendix herein, pages 31 to 43. The opinion of the District Court is not reported.

Jurisdiction.

The judgment of the Court of Appeals was entered on March 28, 1950. The jurisdiction of this Court to review by writ of certiorari the judgment complained of is conferred by Title 28, United States Code, Section 2101.

Questions Presented.

(1) Whether a Trustee in a corporate reorganization should be surcharged for paying out estate monies, without notice to the Court or any interested party, and in a manner "deserving of censure", where it appears that

the Trustee had sole control over the matter and admitted that he was "fooled" in making the payments objected to by the debtor and by the creditors as an unwarranted wasting of trust funds and a fraud upon the estate.

(2) Whether a Trustee in a corporate reorganization should be surcharged for an amount of rent claimed to be allocable to estate matters, when the said amount was taken each month out of trust funds and paid by the Trustee in part payment of his private rent, without notice to the Court or any interested party.

3. Where there were no separate findings of fact as required by Rule 52 (a) of the Rules of Federal Procedure, and where no findings of fact appeared in the District Court's opinion or memorandum of decision as required by said Rule 52 (a), other than an indirect negative suggestion, was it error for Court below to regard a recital in the District Court's *ex parte* order that the payments to Manning "cover expenses necessarily incurred by the Trustee in the discharge of his duties" as a finding of fact? Is a recital in an order a compliance with Rule 52 (a)?

4. Was it error for the Court below to sustain as a finding of fact the District Court's statement in its order that the Manning payments "cover expenses necessarily incurred by the Trustee in the discharge of his duties" when there is not one iota of evidence in the entire record to support such a finding, and, with regard to the rent charge, to conclude that it was an advantage to the estate?

Reasons for Granting the Writ.

It is respectfully submitted that the Court of Appeals decided substantial questions of law in a manner not in accord with the pertinent decisions of this Court for the following reasons, among others:

I.

It is fundamental that a Trustee owes to his trust the obligation of acting with competence and prudence in the management of the estate. Such obligation imposes upon a Trustee the duty of knowing and approving as necessary the expenditure of trust monies. Good faith does not exonerate a Trustee from this duty, nor is it a justifiable excuse that a Trustee was "fooled" into expending trust monies. Our courts have universally held that the sanction for the failure to exercise due diligence in the management of an estate is a surcharge. When the lack of due diligence takes on the form of handing over each week a sum of money to a bookkeeper, under conditions where an obvious fraud is being committed on all parties, there can be no doubt upon whose shoulders the loss should fall.

It is to be pointed out that the Trustee employed Manning as a bookkeeper and paid him a salary of $100.00 per week for the period April 1943 to May 1945. Until the Trustee's final account was filed with the District Court on August 29, 1947, it nowhere appeared that the Trustee was paying Manning, in addition to his weekly salary, checks drawn on trust funds and charged as expenses. Each week a check was paid regularly to Manning for the entire period of his employment, the said checks sometimes running in excess of Manning's salary.

Several hearings were held before the District Judge and in the testimony which was presented it appeared that the Trustee was unaware that the estate was being regularly mulcted and that he was being "fooled". The District Court allowed as charges against the estate all of Manning's expenses except the part which was so obviously fraudulent that a surcharge had to be made on the very broad basis of the Trustee's "bad accounting practice". The Court below has permitted the Trustee

to escape this surcharge even though it found this matter "deserving of censure".

It is respectfully submitted that whatever can be censured must be traced back to a shortcoming or fault on someone's part. Quite obviously the only party here involved is the Trustee who had sole control of this censurable matter. As such there must have been fault on his part and in instances of this kind it is superfluous to point out that a surcharge must be made against the party at fault. It is contrary to logic and justice and to the consistent holdings of our Courts to impose resulting losses, arising out of the Trustee's fault, upon an innocent debtor.

II.

It is equally fundamental in our law that a Trustee, as a fiduciary of the parties in interest, is bound to deal with the estate with scrupulous impartiality and with a complete detachment from self interest. No personal considerations must motivate him. Honesty alone is not the standard of his conduct but an undivided loyalty to his beneficiaries that must not be allowed to be diluted for any reason whatsoever.

Consequently it is no excuse for the Trustee to have a portion of his private rent paid out of trust funds on the ground that the said portion of rent could be charged to the estate business. Without notice to any of the parties in interest and without the approval of the District Court, the Trustee regularly, for the period April 1944 to December 1946, paid part of his own rent out of trust monies. It was not until the filing of the Trustee's account in August 1947 that this matter came to light. By the very nature of the payments thus made, the Trustee is to be surcharged, otherwise judicial approval will be given to a principle which is abhorrent to the law governing fiduciary relationships.

If the judgment of the Court below is allowed to stand there will be a definite conflict on analogous facts in the decision of the Court below as compared with a long line of similar consistent holdings in other Circuits.

Wherefore, it is respectfully prayed that a Writ of Certiorari issue to the United States Court of Appeals for the Third Circuit.

New York, New York, June 21, 1950.

Respectfully submitted,

THOMAS P. MESICK,
Attorney for Petitioner.

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PETITIONER'S BRIEF.

I.

In setting aside the surcharges, the Court below has uprooted the settled law of the land.

A careful reading of the opinion reported at 181 Fed. (2d) 119 (Appendix, pp. 31-43) demonstrates that the Court below, while mindful of conduct on the Trustee's part which was "deserving of censure", nevertheless felt that the matter of the Manning surcharge was a "very minor phase" of a business reorganization where there was involved in all over three million dollars of receipts and disbursements. Accordingly, in the Court's way of thinking, the obligation of a Trustee to his beneficiaries

is to be determined by varying degrees of conduct as compared with final results, and not by the nature of the fiduciary relationship itself.

No argument is made at this time of the many factual inaccuracies to be found in the opinion of the Court below—as, for example, the statement that the Trustee handled over three million dollars in receipts and disbursements. By-passing this fictitious standard adopted by the Court as a measure of the Trustee's course of conduct, and even granting, for present purposes, that the opinion is factually sound, it follows, nevertheless, that the Court below has flagrantly misapplied the principles of controlling law on the subject and has done irreparable violence to a long line of consistent holdings. As an illustration, the Court cites three cases as authorities that the Manning surcharge should not be imposed against the Trustee. These cases will be commented upon briefly.

(a) *Gutterson & Gould* v. *Lebanon Iron & Steel Co.*, cited as C. C. M. D., Pa., 151 Fed. 72, 75, 77, 78, is claimed to be authority for the inapplicability of the Manning surcharge, as "he (the Trustee) has not been found in positive fault" (citing the *Gutterson* case) "or negligent".

In the *Gutterson* case, receivers had been appointed for a failing business. They continued operations at additional losses, and the issue was whether they were liable individually as being in positive fault. At page 77 of its opinion, the Court said:

> "The business was not their own, and they were not in a position to take any chances with it; nor in putting them in charge would it have been understood that they were to carry it on regardless of results and at all hazards. This was not the kind of management which the court looked for and had reason to expect."

The court concluded that the receivers *were in positive fault* for losses suffered by the estate and imposed surcharges for such losses, holding at page 80 of the opinion:

> "In order to meet the claims of creditors, they will be further surcharged with an amount, which, with the cash on hand and the available assets, treated as such, will be sufficient to pay in full the unsecured outstanding indebtedness of the receivership and the cost of the accounting, which they must also bear. To prevent misunderstanding, it may be well to note in this connection that while all the matters which have been considered contribute, each to the extent that it goes, to this result, this is particularly true of the charge of mismanagement in running the business at a loss, without the ordinary check by which it would have been prevented, to which the contracting of the unpaid indebtedness, without anything to meet it, is directly traceable, and which is thus, of itself, sufficient to sustain the surcharge which it is unfortunately found necessary to make."

(b) In the case of *In re Lambertville Rubber Co.*, 3rd Cir., 111 Fed. (2d) 45, 50, cited by the Court below as similar authority for its dismissal of the Manning surcharge, the facts appeared as follows:

> The appellee had been appointed Trustee in a 77B proceeding, and out of funds coming into his hands, he paid Social Security taxes to the United States and the State of New Jersey in order to obtain certain tax credits. Since the debtor was not reorganized, the Trustee's purpose failed of accomplishment. At page 48, the Third Circuit Court of Appeals said, in holding the Trustee liable for these payments:

"It may be contended that this ruling places a burden of prescience upon the Trustee, but we think that is not the case. The Trustee is charged with an intimate knowledge of the estate which he is administering and if he pays claims out of time and without the protection of an order of the court affirmatively authorizing such conduct, he must be certain that such payments will work no harm to any creditor. Under such circumstances he acts at his own risk and if his judgment is bad, he must accept the consequences."

In the instant case, the Trustee's regular handing over of trust monies under circumstances where he readily admits he was "fooled", stamps upon him an indelible mark of negligence for which a surcharge should follow as matter of law. Yet the Court below set a minimum surcharge aside. Contrast this result with the same Court's conclusion in the *Lambertville Rubber* case (*supra*), where it appeared that the Trustee paid due and outstanding taxes, and where it was held, as a result, on page 50 of the opinion:

"We conclude that the Trustee acted negligently in paying the taxes referred to in this opinion. He must therefore be surcharged. *U. S. ex rel. Willoughby* v. *Howard,* 302 U. S. 445, 58 S. Ct. 309, 82 L. Ed. 352; *In re Hoyt & Mitchell,* D. C., 127 F. 968; *In re B. A. Montgomery & Son,* D. C., 17 Fed. (2d) 404; Amendatory Act of June 22, 1938, 11 U. S. C. A. 104, sub. a."

(c) The final authority cited by the Court below, *In re Schoenfeld, et al.,* 3rd Cir., 183 Fed. 219, 221, is not applicable to present matters, nor does it stand for any controlling legal principles. At page 221, cited by the court below, the only language in

any way germane is the following, which is self-explanatory:

> "It appears, therefore, that the receiver was called on by the exception to his account to meet a charge of fraud, and though no fraud was found, he was condemned on a ground not specified in the exceptions, not necessarily involving fraud, and of which he had no notice. This, we think, was wrong."

In the case at bar, the Trustee is, of necessity, to be surcharged for the Manning account, as ordered by the District Court, on the inflexble authorities which the Court below itself has cited. For the Court to misapply controlling principles to obvious circumstances of positive fault and neglect is to write into our law a new and unwholesome standard of conduct whereby due diligence, ordinary prudence and sound judgment are cast down like false idols. In their place is adopted a school of thought which concludes that if the loss to the beneficiaries is a minor one, it is not important. Nor in this process of reasoning is any action beyond censure to be taken with regard to a Trustee whose sole excuse for his mismanagement of estate matters is that he was "fooled".

The Court below attempts to stretch the Trustee's conduct out of the realm of mismanagement by taking a position that the District Court's sole reason for the Manning surcharge was its disapproval of the Trustee's accounting practice. It is respectfully submitted that the District Court could not and did not overlook the positive loss to the estate of substanial sums of money paid to Manning, for only a part of which the Trustee was surcharged. As to this, the Court below reasoned that:

> " * * * since this phase of the matter was before the Court for the first time with no opportunity of warning the Trustee that his method was frowned upon, it does seem that the surcharge is too drastic a remedy * * * "

"This phase of the matter" was before the Court for the first time only because the Trustee chose to have it that way. It was not until his account was filed on August 29, 1947, after the consummation of the plan, that an inspection of payments made by him could be had. At any time in the several years before the plan was adopted, the Trustee could have sought the advice of interested parties or the approval of the Court if he so desired. Of course, there was "no opportunity of warning" him, as it could not be presumed that he was being "fooled" into wasting trust funds. The Court and the beneficiaries are entitled to expect no such fatuous or wrongful conduct. Since the Trustee persisted in it, to the estate's loss, he should be made to bear at least a part of that loss. Such is the settled law of the land. The Court below, in deciding as it did, has eviscerated such outstanding decisions as:

> *Reichert* v. *Bard,* 81 Fed. (2) 749, 7th C. C. A.;
> *Chappel* v. *First Trust Co.,* 30 F. Supp. 765;
> *Evans* v. *Williams,* 276 Fed. 650, 6th C. C. A.;
> *Carson, Pirie, Scott & Co.* v. *Turner,* 61 Fed. (2d) 693; 6th C. C. A.

The above-cited cases and a whole host of decisions on the subject stand for the firm and unalterable proposition that a Trustee is bound to use due diligence in the management of affairs of the estate, and should be made to account for any assets dissipated through his negligence, mismanagement, wrongful conduct, or poor judgment.

Although the admitted facts of the instant matter show precisely the existence of conditions demanding a surcharge, the Court below has argued its way around the inevitable result, and in contorting the facts and the law for the purpose of exonerating the Trustee at all events, it has torn out the heart of our jurisprudence on this subject. For a reason so vital, the case should be reviewed.

II.

In vacating the surcharge for rent, the Court below has similarly upset basic principles relating to fiduciaries.

In filing his account, the Trustee revealed that the rent of his private law office had been reduced by the sum of $50 per month for a period of over two and one-half years. This reduction resulted from the payment out of trust funds in the Trustee's possession of the said sum of $50 each month directly to the landlord of the Trustee's own office.

The justification for this procedure is the claim that a part of the Trustee's office had to be used for the management of the estate. Of course, the Trustee had not made known this fact to the beneficiaries of the trust, nor had he obtained the approval of the District Judge, if indeed such approval could have been obtained.

The Court below extended itself beyond description to acquit the Trustee of a necessary surcharge. While it acknowledged that "it would have been far more advisable to have first presented the matter to the Court", the opinion below concludes that there is "not the slightest intimation of failure of duty or of negligence", and, there is no thought of bad faith" (Appendix, p. 37).

Assuming even that the Trustee was motivated by good faith and proper intentions, the fact remains that either directly or indirectly he had some personal benefit

out of the trust. It is commonplace to state, under such conditions, that he must disgorge the amount by which he has thus been benefitted. Settled principles are restated in the case of *Phelan* v. *Middle States Oil Corp.*, 154 Fed. (2d) 978, where the Court of Appeals for the Second Circuit said at pages 991 and 992:

> "Having in mind such cases as *Crites, Inc.* v. *Prudential Co.*, 322 U. S. 408, 64 S. Ct. 1075, 1079, 88 L. Ed. 1356, and others cited below, we think the general principles applicable here are as follows: A receiver, as 'an officer or arm of the court', is a trustee with the highest kind of fiduciary obligations. He owes a duty of strict impartiality, of 'undivided loyalty' to all persons interested in the receivership estate, and must not 'dilute' that loyalty. He is 'bound to act fairly and openly with respect to every aspect of the proceedings before the court' * * * The court, as well as all the interested parties, have 'the right to expect that all its officers', including the receiver, will not 'fail to reveal any pertinent information or use their official position for their own profit or to further the interests of themselves or any associates'.[3]
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>
> "The rule that a receiver must not be motivated by personal considerations is prophylactic; its sanction is a surcharge."[12]

In giving effect to the fundamental rules set forth in the foregoing citation, our Courts have consistently re-

"3. *Crites, Inc.* v. *Prudential, supra, Woods* v. *City National Bank & Trust Co.*, 312 U. S. 262, 263, 61 S. Ct. 493, 85 L. Ed. 820.

12. *Woods* v. *City National Bank & Trust Co., supra; Weil* v. *Neary*, 278 U. S. 160, 173; 49 S. Ct. 144; 73 L. Ed. 243; *Crites, Inc.* v. *Prudential Co., supra; Jackson* v. *Smith, supra. Magruder* v. *Drury*, 235 U. S. 106, 119, 120; 35 S. Ct. 77, 59 L. Ed. 151."

fused to allow a Trustee to enjoy any private advantage out of the trust even in such instances where the advantage is indirect and the expense to the estate would have to be incurred at all events. Thus, for example, in *Sexton* v. *Sword S.S. Line,* 118 Fed. (2d) 708 (2nd C. C. A.), it was held that where a debtor, in the normal operations of its business, paid a commission to a steamship broker for the obtaining of a charter, the trustee, who was the broker's partner, was required to set off against his allowance one-half the amount of the commission.

There can and should be no dilution of the high degree of untrammeled loyalty owed by a Trustee to his beneficiaries, for once there is a relaxing of the rule of "absolute rigidity", the life-blood flows out of the veins of the trust relationship.

The Court below, by its decision in this respect, has elected to place a question mark after each of the duties demanded of a trustee in dealing with his trust. In thus lowering accepted standards, the decision at bar conflicts, in some instances word for word, with settled rules. Having in mind the opinion of the Court below relating to its dismissal of the rent surcharge, the following words of the case cited should be carefully read. In this case, *In re C. M. Piece Dyeing Co., Inc.,* 89 Fed. (2d) 37, the Second Circuit held in an opinion by Judge Learned Hand, where a Trustee was surcharged for allowing rent charges to accumulate, that:

> "Every consideration of despatch and economy demanded that he either abandon the premises and the machinery, or sell it, or remove it. As for the last, he himself says that it would have been costly, and the fact that he started to sell, proves that the right course was to sell. If he had had any doubts, he should have applied to the court. The referee has allowed him a month, which seems to us quite enough, perhaps too much. Nor did the

judge seek to defend his conduct; he excused him only because he had acted in good faith, relying upon *Evans* v. *Williams, supra,* 276 F. 650. It is, however, an error to suppose that good faith will always excuse derelict and negligent administration of an estate. *In re Curtis,* 76 F. (2) 751 (C. C. A. 2); *Covington* v. *Hawes-La Anna Co.,* 245 Pa. 73, 91 A. 514, Ann. Cas. 1915D, 1254; *In re Angell,* 131 Mich. 345, 91 N. W. 611; *Campbell* v. *Hargraves,* 181 Ark. 492, 26 S. W. (2d) 876; *Gutterson & Gould* v. *Lebanon I & S Co.* (C. C.) 151 F. 72. More is required than honesty; a receiver is a fiduciary, he undertakes to care for the property and manage it for the creditors, to act with assiduity and with reasonable competence. Restatement of Trusts, 174. If he is inert, if his conduct does not match even with the least exacting standards of competence, he will be charged. In *Evans* v. *Williams, supra,* it is true that the court put stress upon the receiver's good faith, but it was also at pains to justify his conduct as an administrator; it excused him only after deciding that he had been misled by assistants whom he had chosen with care enough. We are unwilling to set a standard which shall exonerate honest administration, however sluggish, however indifferent, however inconsiderate. Creditors are entitled to something more, and gentlemen who accept such positions must understand that they are to be alert and active in the business, though it proves exacting. If they are not willing to give their time to it, they had best not accept, for if they fail, they will be held accountable."

It is to be pointed out that, given an opportunity to explain his dereliction of duty in this respect, the Trustee testified:

"If I did wrong, I am sorry."

The Trustee's professed sorrow is no excuse for saddling upon the estate a part of the rent of his private office for a period in excess of two and one-half years. This expense is clearly the Trustee's own, and it was error for the Court below to remove the surcharge from the Trustee and foist it upon the estate. This Court should not allow such error to prevail.

III.

A recital in an order entered upon a memorandum of opinion is not a compliance with Rule 52 (a) of the Federal Rules of Civil Procedure which requires the facts to be found specially, and the Court below was not justified therefore in treating such recitals as findings of fact.

Since the Court below, in attempting to explain away both the Manning payments and the rent charge, has asserted, as justification therefor, that these expenses were incurred in the discharge of the Trustee's duties and as an advantage to the estate, it becomes necessary to examine the Court's conclusions in these respects.

Rule 52 (a) requires that in all cases tried upon the facts without a jury the Court must either find the facts specially, or the facts must appear in the opinion or memorandum of decision. In the case at bar there were no findings of fact stated specially or separately, and the only statement which appears in the opinion with regard to the Manning payments is:

> "This is not to suggest that this expense was not necessarily incurred by the Trustee in the discharge of his duties" (R. 123a).

After the Memorandum Opinion was filed the Trustee, without notice, prepared an order thereon and submitted

the same *ex parte* to the trial Judge, who signed it and it was filed (R. 127a).

In the recitals in said order, prepared by the Trustee, the negative suggestion which appeared in the opinion is converted into an affirmative statement that the Court is of the opinion that the payments to Manning "cover expenses necessarily incurred by the Trustee in the discharge of his duties".

The Court below in its opinion has elevated the above quoted words, taken from the recitals of the order, into a finding of fact, and has italicized the same as the basis for vacating the Manning surcharge (Appendix, p. 35).

It has long been the law in the Federal courts that compliance with Rule 52 (a) is mandatory. There must be findings stated specially and separately.

> *Interstate Circuit* v. *United States,* 304 U. S. 55;
> *Hecht et al.* v. *New Zealand,* 1 F.R.D. 593, affirmed 121 F (2) 442;
> *National Popsicle Corp.* v. *Icyclair Inc.,* 119 F (2) 799;
> *Marborough Corp.* v. *United States,* 172 F (2) 787.

In 1947, Rule 52 (a) was amended by the addition of the provision reading:

> "If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein."

In the above cited case of *Interstate Circuit* v. *United States,* which was decided by the United States Supreme Court in 1938, it was held that the opinion of the trial Court was no substitute for the requirement of Rule 52 (a) calling for findings to be separately stated. However, since the 1947 amendment of Rule 52 (a), the findings may now be stated separately or they may appear in the

opinion. Such is the extent of the rule. The requirements of Rule 52 (a) are mandatory and the recitals in an order are no substitute.

The case of *Kelley* v. *Everglades District,* 319 U.S. 415, at pages 421 and 422 contains the following significant language:

> "It may be that adequate evidence as to these matters is in the present record. On that we do not pass, for it is not the function of this Court to search the record and analyze the evidence in order to supply findings which the trial court failed to make. Nor do we intimate that findings must be made on all of the enumerated matters or need be made on no others; the nature of the evidentiary findings sufficient and appropriate to support the Court's decision as to fairness or unfairness is for the trial court to determine in the first instance in the light of the circumstances of the particular case. We hold only that there must be findings, stated either in the court's opinion or separately, which are sufficient to indicate the factual basis for the ultimate conclusion."

In the case at bar, the Court below erred in treating the recitals in the order as a compliance with Rule 52 (a). The order should have been vacated and the case remanded to the District Court with instructions to make findings. At least, the Court below should not have taken it upon itself to make its own findings in an obvious effort to uphold the Trustee by making excuses for him which he himself did not even advance.

IV.

The finding that the Manning payments "cover expenses necessarily incurred by the Trustee in the discharge of his duties" is not supported by any evidence. The said finding is clearly erroneous, as is the finding that the rent charge was an advantage to the estate.

A meticulous reading of the entire record will reveal that nowhere in the testimony, nor in any of the exhibits, records and documents does it appear that there was any evidence of any kind to support the statement that the payments "cover expenses necessarily incurred by the Trustee in the discharge of his duties" (Appendix, p. 35), or that the closeness of the rented room "was an advantage to the Trust estate" (Appendix, p. 37).

Even the District Judge in his memorandum of opinion could not put his finger on any evidence pointing to the propriety of the Manning payments and accordingly the said opinion contains the statement: "It is admitted by the Trustee that these sums were paid to reimburse the said employee for expenses incurred and paid by him in the discharge of his duties" (R. 123a). The record contains no such direct admission. The only statement by the Trustee in his testimony with respect to the payments to Manning is "If he fooled me, he fooled me" (R. 330a, 331a, 332a).

It is the well established principle that a finding must be supported by evidence:

> *Del Vecchio* v. *Bowers,* 296 U.S. 280, 286;
> *Crowell* v. *Benson,* 285 U.S. 22, 46, 49, 50.

Also, that a finding is clearly erroneous if it is based on no evidence:

Roth Office Equipment Co. v. *Gallagher,* 172 F (2) 452 (6th Circuit);
Wright-Bernet v. *Commissioner of Internal Revenue,* 172 F (2) 343 (9th Circuit);
Sanders v. *Leech,* 158 F (2) 486, 487 (5th Circuit);
Aetna Life Ins. Co. v. *Kepler,* 116 F (2) 1, 4 (8th Circuit).

In the case of *Crowell* v. *Benson, supra,* the United States Supreme Court held that facts conceivably known to the judge but not put in evidence so as to permit scrutiny and contest will not support a finding.

If the findings are not supported by evidence they will be rejected as clearly erroneous.

United States v. *U. S. Gypsum Co.,* 333 U.S. 364.

On the subject of any admission by the Trustee that he gave away estate money to Manning there is some testimony on page 611a of the Record that the Trustee gave Manning $500 and $250 which Manning stated he did not dare to put into the expense statement. Nowhere in the Trustee's account is there any record of such payments, other than as they may be concealed in the padded expense vouchers.

There is no evidence to support the finding that the expenses were necessarily incurred by the Trustee. The evidence is quite to the contrary. No words on this subject could be clearer than the Trustee's own. He called it: "A mistake of mine", and appreciated "that this looks very, very bad" (R. 331a). In the face of such convicting admissions, a finding by the Court below that the expenses were necessarily incurred in the interest of the estate is clearly erroneous. The Trustee himself knows that they were not and says so. For his mistakes he should be made to pay. For the savings he made on his own rent, at the

expense of the Trust, he should be compelled to turn back the money where it belongs. In the law of fiduciaries no rules are more basic.

Nor is it sufficient to conclude that the matter is a minor one as the Court below felt. True, the dollar values involved in such cases as *U. S. ex rel Willoughby* v. *Howard*, 302 U.S. 442, are not here present. Yet fundamental principles remain the same and should apply with the same force and effect regardless of amounts involved. As in the last cited case, the Trustee herein has clearly failed in his official duty of exercising ordinary care in the maintenance of trust funds. He should be made to account. He should not be above the law.

Respectfully submitted,

THOMAS P. MESICK,
Attorney for Petitioner.

APPENDIX.

Judgment of Court Below.

UNITED STATES COURT OF APPEALS,

FOR THE THIRD CIRCUIT.

No. 9894.

In the Matter of MARINE MAINTENANCE CORP. EDWARD R. McGLYNN, as Trustee in proceedings for reorganization of Debtor,

Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY.

Present:- -McLAUGHLIN, *Circuit Judge*, and FEE, *District Judge.*

JUDGMENT.

This cause came on to be heard on the record from the United States District Court for the District of New Jersey and was argued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the Order of December 15, 1948 of the said District Court allowing $10,000 as compensation for services to appellant-trustee in addition to the sum of $15,000 previously allowed be, and the same is hereby affirmed. That part of the order of the District Court dated January 5, 1949, which sustains exceptions (2) and (3) filed by Debtor to the final account of appel-

lant-trustee, and fixing surcharges against the Trustee with respect to the second exception in the sum of $1,340.08 and with respect to the third exception in the sum of $1,725.00 is reversed. The order dated January 5, 1949, amending the aforesaid order of December 15, 1948, and providing for the deduction of $3,065.08 (the aggregate of the surcharges above mentioned) from the final allowance of $10,000 to the appellant-trustee is reversed.

Attest:

IDA O. CRESKOFF,
Clerk.

March 28, 1950.

Opinion of Court Below.

UNITED STATES COURT OF APPEALS,

FOR THE THIRD CIRCUIT.

No. 9894.

In the Matter of MARINE MAINTENANCE CORP.,
Debtor-Appellee.

EDWARD R. McGLYNN, as Trustee in Proceedings for Reorganization of Debtor Under Chapter X of the United States Bankruptcy Act,
Appellant.

No. 9911.

In the Matter of MARINE MAINTENANCE CORPORATION,

Debtor-Appellant.

No. 9930.

In the Matter of MARINE MAINTENANCE CORPORATION,
Debtor.

GREGORY FEREND,
Creditor-Appellant.

No. 9968.

In the Matter of MARINE MAINTENANCE CORPORATION,

Debtor-Appellee.

THEODORE GRANIK,

Claimant-Appellant.

APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY.

Argued October 6, 1949.

Before McLAUGHLIN and O'CONNELL, *Circuit Judges* and FEE, *District Judge.*

OPINION OF THE COURT.

(Filed March 28, 1950.)

By McLAUGHLIN, *Circuit Judge.*

These matters embrace four separate appeals in a Chapter Ten reorganization proceeding.

The first appeal is by the Trustee from the amount of fees awarded him and from two surcharges against him.

Edward R. McGlynn, was one of two trustees appointed in this matter on February 23, 1943. The other trustee resigned on October 11, 1943, and McGlynn thereafter functioned alone. The Debtor owned and operated a shipyard in Bayonne, New Jersey. On February 18, 1943, just prior to the Trustee's appointment, the Government took possession of the shipyard pursuant to an order of possession in a related condemnation proceeding. That possession was not relinquished until March 15, 1945. Thereafter, the Trustee leased the yard to a new cor-

poration. He never actually operated the shipyard himself.

The Referee found that the administration of the Chapter Ten proceeding was extremely successful. A plan of reorganization was confirmed by order of June 26, 1947, and the shipyard was returned to the Debtor with a cash working capital of $150,000.

At the time of the appointment of the trustees, the United States had instituted condemnation proceedings against all of the Debtor's real and personal property (cash, accounts receivable and choses of action excepted). An indictment had been returned against the Debtor, its president and treasurer. This involved numerous charges of fraud in connection with work performed and materials furnished the Maritime Commission. There was also pending, a civil action by the Government for penalties arising out of the criminal charges.

The Trustee assisted his attorneys materially in the criminal trial. That case lasted eight weeks and resulted in acquittals of the Debtor and its president, and in the conviction of the treasurer. The treasurer's conviction was later reversed on appeal. The Trustee also rendered important help in various matters arising out of the condemnation and in the Government's civil litigation. Throughout the period of his trusteeship it was necessary for him to maintain a bookkeeping and accounting staff to assist him in attending to the numerous details connected with preparation of the trial of the indictment, collection of accounts, settlement negotiations with the Maritime Commission, review of employees' records for the purpose of refunding of war bond deductions, processing some 550 proofs of claim, taking care of New Jersey Unemployment Compensation and Federal Social Security returns for a considerable period prior to the trusteeship and various problems regarding the financing of the Debtor.

There were approximately 170 petitions, orders, reports, stipulations and memoranda filed with the Clerk in

the proceeding. The Trustee prepared most of these and participated in all of them. The trusteeship entailed voluminous correspondence. The Trustee had assistance on occasion from various members of his law office personnel and one of his associate lawyers spent practically full time on trusteeship affairs for over two years.

The Trustee filed two itemized petitions for services of 151 pages and 55 pages respectively. He was allowed a total of $25,000 for his services; $15,000 of this by way of ad interim compensation. There is a dispute between the parties regarding the correctness of the Referee's calculation of the sum available for fees and disbursements. It is not necessary for us to go into that because there is no indication that the Referee's recommendation of additional compensation to the Trustee was based on anything but the value of the latter's services. Later that whole dispute was aired before the District Judge on the Trustee's specific exception to that part of the Referee's report. Having considered the Trustee's petition for allowance in connection with the Referee's report and the exceptions thereto, the Court, without any qualification, found:

> "That the sum of $10,000.00, in addition to the allowance of $15,000.00 heretofore made, *is reasonable and just compensation* for the services rendered by Edward R. McGlynn, Esq., the Trustee, and he hereby is allowed the sum of $10,000.00 as compensation for such services, in addition to the sum of $15,000.00 heretofore allowed." (Emphasis supplied.)

The Trustee is an experienced lawyer. Generally speaking, he performed an excellent job of work in this tedious, exacting matter. He was instrumental in the good over-all results obtained. However, we cannot say that the sum awarded him is so unreasonable as to warrant interference by this Court. Dickinson Co. vs Cowan, 309 U.S. 382, 389; In re Standard Gas & Electric Co., 3 Cir., 106 F.

2d 215, 216; Newman vs Ambassador Apartments, Inc., 3 Cir., 101 F.2d 307, 308; Oklahoma Ry. Co. vs Johnston, 10 Cir., 155 F.2d 500, 502; In re Long Island Properties, Inc., 2 Cir., 150 F.2d 313, 314.

The two surcharges against the Trustee present a radically different situation. The first involves weekly payments by him to his chief accountant in reimbursement to the latter for expenses incurred and payments made by him in the discharge of his duties. These totalled $1,340.08. The Court found that the payments "*cover expenses necessarily incurred by the Trustee in the discharge of his duties* * * *." (Emphasis supplied). But because the Court felt that if it allowed the payments it would be lending its approval to the "bad accounting practice" of "paying the sums without supporting vouchers or receipts" the Court sustained this exception to the Trustee's account.

We agree that the method, or lack of method, displayed by the Trustee in this very minor phase of a business reorganization in which he handled total cash receipts of $3,534,700.68 and disbursed $3,468,954.33, was slipshod and deserving of censure. But in the light of the finding that the payment covered expenses necessarily incurred by the Trustee in the discharge of his duties, we do not think the surcharge warranted. He has not been found in positive fault (Gutterson & Gould vs Lebanon Iron & Steel Co., C.C.MD., Pa. 151 Fed. 72, 75, 77, 78) or negligent. (In re Lambertville Rubber Co., 3 Cir., 111 F.2d 45, 50; In re Schoenfeld, et al., 3 Cir., 183 Fed. 219, 221.) Since the District Judge in both his memorandum opinion and his order has given clear expression to the thought that he does not approve of the Trustee's accounting practice, which is the Court's sole reason for the surcharge, and since this phase of the matter was before the Court for the first time with no opportunity of warning the Trustee that his method was frowned upon, it does seem that the surcharge is too drastic a remedy, reflecting as it does upon the Trustee in a manner not supported by the findings.

The second surcharge concerns a disbursement for rent. This amounts to $1,725.00 at the rate of $50. a month. It was paid for an unused room in the Trustee's suite of law offices. The room was available because the lawyer who had occupied it was in the Army. Office space was admittedly almost impossible to obtain in the desired location. The rent for the premises during the Trustee's occupancy was paid by him directly to the landlord's agent. The Court accepted the Trustee's explanation that his only reason for taking over the particular quarters was that no other space was readily available in the years 1944, 1945 and 1946. The Court did not question the necessity of the expenditure, but because it considered that approval should have been first obtained, it made the surcharge. What the Court said was:

> "The third exception is directed to rents in the total amount of $1,725.00, for office space occupied by the Debtor during the period of reorganization, but formerly occupied by the Trustee. It is admitted that a monthly rental of $50.00 was paid to Albert Greenfield & Co., for this space, which was apparently released by the Trustee. The only explanation of the Trustee is that no other space was readily available during the years 1944, 1945, and 1946, and *we accept this explanation as true because we know that office space was at a premium during this period. The expenditure may have been necessary,* but it is our opinion that it should not have been made without first acquainting the Court with the necessity of making it and obtaining the Court's approval. This excepton is, therefore, sustained, and the Trustee will be surcharged the amount of $1,725.00." (Emphasis supplied.)

The circumstances bringing about the use of the particular room were extraordinary. Wartime conditions had absorbed practically all convenient space. The room itself

would not have been available except for those same circumstances. It was occupied for three years by the Trustee without objection from any interested person. The Trustee argues that under his broad powers, he had authority to make such expenditure without the necessity of applying for an order; that it was a proper and necessary incident to the discharge of his duties as Trustee. Nevertheless, because the room had been in his law office suite it would have been far more advisable to have first presented the matter to the Court. Aside from this, there is not the slightest intimation of failure of duty or of negligence. There is no thought of bad faith and nothing to suggest that the trust estate was the loser in the transaction or that the Trustee dealt with it * * * "in such a way as to make a personal profit for himself." Magruder vs Drury, 235 U.S. 106, 120. The room was convenient and obtainable. Its closeness to Trustee's law office was an advantage to the trust estate. Under all the facts we do not think the surcharge is justified.

The second and third appeals are by the Debtor and Gregory Ferend, former president and controlling stockholder (through another corporation) of the Debtor. They urge that certain exceptions to the Trustee's account should not have been dismissed.

The first of those exceptions had to do with the employment of a stenographer from Trustee's law office for the use of the Trustee. The exception was dismissed by the District Court without comment. Under the order of appointment, the Trustee had the power to employ and discharge such help and the uncontradicted testimony is that, "Substantially and almost exclusively, almost to the extent of 100 per cent, she was doing Marine Maintenance work". As the Trustee further said, "It is impossible for a girl in an office to be kept exclusively within a fence with an iron curtain around her." We do not find the Trustee's judgment at fault in this instance. Nor do we find bad faith, fraud or loss to the estate.

Objection was also made to the Trustee having had a firm of certified public accountants prepare the estate returns for withholding taxes, Social Security and Unemployment Insurance. There was no showing of any unwarranted conduct of the Trustee in connection with this item. It need not be discussed.

The remaining exception has two independent parts. The first concerns claims of the Debtor against the Government amounting to $35,977.21 for repairs to the ships Northern Sword, Donbass and Yankee Sword. The Trustee discovered that these and twenty-eight other claims for repairs had not been billed by the Debtor. Their total came to $757,771.89. The Government refused to pay them pending the disposition of its civil false claims suit, above mentioned, which had to do with entirely different work by the Debtor for the Government. There were other, and entirely separate, repairs to the Northern Sword, Donbass and Yankee Sword which were involved in the false claims suit.

On September 7, 1944, there was a conference at Washington between the Trustee and the attorneys for the Debtor (who also represented the Trustee in the false claim litigation) and various Government people. A compromise settlement of the false claim suit was agreed upon and, in accordance with it, the Trustee was to receive $102,130.67. A stipulation covering this was agreed upon. This was drawn by the Debtor's attorney and approved by the Debtor. It was not executed immediately, as the Court's approval, on notice to creditors, was first needed. The Trustee then set out the situation in a petition to the Court. The creditors consented and there was an order authorizing the compromise filed September 25, 1944. The stipulation was executed at the same time. The stipulation stated that the Trustee would receive the $102,130.67 in full settlement for all work performed and materials furnished for the twelve ships involved in the false claim suit. In the twelve ships were included the Northern Sword, Donbass

and Yankee Sword. For the agreed sum the Trustee was to execute and deliver a general release to the Commission covering all work done and materials furnished to the twelve ships.

Because of the stipulation, the Maritime Commission requested the Trustee to return checks totalling $35,977.21 which had been sent covering the bills to Northern Sword, Donbass and Yankee Sword in connection with the other claims against those ships and which checks, it was stated, had been sent by mistake. The Trustee told the Commission that "As Trustee I can't take checks you are going to stop payment on" and he returned those checks to the Commission. Regarding this the Trustee testified, "I think I would give it [the money] back to anybody who told me he had paid me by mistake and fight it out decently, as we should fight it." He then presented a petition to the Court advising that the Commission would not give him the compromise settlement money unless he in turn, delivered the general release called for by the stipulaton. The latter specifically referred to the particular claims of the Debtor against the twelve ships. It did not refer to the other items against Northern Sword, Donbass and Yankee Sword which totalled $35,977.21.

The Court made an order on February 5, 1945, authorizing the Trustee to accept the $102,130.67 and to deliver a general release. In addition, the Trustee was authorized to institute a plenary suit for $35,977.21. The attorney for the Debtor, who had taken part in the compromise conference and who had drawn the stipulation, participated throughout the above detailed proceedings. The Trustee testified that he did not commence the plenary action because of specific instructions many times from the Debtor's attorney and from Ferend, who was more anxious to settle the large claim "which resulted in the confirmation of the plan". The Trustee testified that he would have started the suit "anytime they wanted me to." The claim was

assigned to the Debtor. Down to the date of the argument on this appeal, suit had not been commenced.

As already mentioned, the stipulation of settlement of the false claims action referred to certain invoces by number. The three invoices amounting to $35,977.21 were not among these. Without passing on the point, the Court below was of the strong impression that the release defense could not be successfully interposed in a suit based on the three invoices and commented that if there was merit to such claims "there is nothing to prevent the Debtor from seeking to have them paid." At that time the reorganized Debtor had been in control for six months and had done nothing about the claim.

The second half of the exception has to do with the non obtainment by the Trustee of a Certificate of Necessity. It will be recalled that the Trustee never operated the Debtor's business. Prior to the Chapter Ten proceeding there had been an application for such a certificate by the Debtor. The certificate had to do with wartime production and operation and allowed special amortization of wartime assets. The Trustee never found anything connected with a Certificate of Necessity in the Debtor's records. After the criminal trial, included in the papers in the case returned to him by the District Attorney, there was an envelope containing a copy of an informal application for such certificate. That copy apparently had been obtained from Washington by someone acting for the District Attorney. The Trustee testified "that everybody in the case", including the Debtor's own accountant, thought that the copy of the application was the certificate. Later attempts by the Trustee to obtain a certificate nunc pro tunc were unsuccessful.

The District Court was well within its discretion in dismissing the exception. As to the first part of the exception, in compromising certain claims,[1] the Debtor's attorney

1 The Maritime Commission had felt so strongly about those claims, that in connection with them, the Debtor, Ferend and the corporation treasurer had been indicted and tried.

had drawn a stipulation, which, while it called for a general release, was tied into specific vouchers. The consideration intended by the stipulation was not forthcoming except in exchange for the release. Under court order, the release was given. The plenary action indicated by the Court was not started by the Trustee at the request of Ferend, who did not wish any possible interference in the return of the shipyard to him under the confirmation of the reorganization plan. Later the cause of action was in the control of the reorganized Debtor. The balance of the exception has to do with an incident that had apparently occurred prior to the advent of the Trustee although there was no record of it in the files of the Debtor. The only thing the Trustee ever saw concerning a Certificate of Necessity was the District Attorney's photostatic copy of the original application which happened to come to him after the criminal trial. As the Trustee said, everybody connected with the case thought the certificate had been issued. Even after the copy of the application had been received there is no evidence that anyone connected with the Debtor, particularly Ferend, the accountant or the Debtor's attorneys, ever gave the Trustee the slightest intimation that the applicaion had never been approved. Certainly, under the facts, we cannot say that the District Judge acted improperly in dismissing both parts of this exception.

The final appeal is by a creditor, Theodore Granik, from an order disallowing his proof of claim. Granik is a Washington lawyer. It was well known that he had a claim for services rendered the Debtor prior to the filing of the petition for reorganization. In fact, there were eleven orders extending his time to file his poof of claim beyond the date originally fixed, namely, June 1, 1943. Those orders were consented to by the Trustee. The last of them expired April 2, 1945. On April 25, 1947, at the time the plan for reorganization was filed, the Court's order provided: "That the time for filing claims which have not been heretofore filed be extended to and including May 26, 1947." This was consented to by the attorney for the Debtor. That

same order declared, "That Marine Maintenance Corporation, the above named debtor, be and it is hereby determined to be solvent."

On May 21, 1947, the Trustee received from Granik a letter dated May 20, 1947, containing an informal unverified statement of his claim. The Trustee accepted this as the filing of Granik's proof of claim, and, in a letter dated May 21 1947 to his attorney, who had also represented the debtor, he said, "I am sending to you herewith copy of letter received from Mr. Granik, together with the enclosures therein mentioned which letter I am to consider as a formal proof of claim of Mr. Granik and which I am filing, together with the claims of other creditors." On May 27, 1947, the Trustee wrote Granik saying, "In order that your proof of claim for services rendered prior to the appointment of a trustee is in proper form, I enclose herewith two blanks which I have filled out in accordance with the papers you have already sent me, which I wish you would have sworn to and sent back to me." These were returned to the Trustee and filed by him on or about May 29, 1947.

We think it clear that Granik's unverified claim was accepted for filing by, and filed with, the Trustee on May 21, 1947. This was five days prior to the expiration of the time fixed for filing by the order of April 25, 1947. Though the claim was later amended by being put into formal shape and verified, it did not in any way present "a new claim or interest". Collier on Bankruptcy, Vol. 6, p. 2783. And see Collier, Vol. 3, pp. 170, 171. In the matter of In re Prindible, 3 Cir. 115 F.2d 21, 23, we said, " * * * that while the limitation in the Bankruptcy Act for the filing of creditors' claims * * * has been construed strictly with respect to an original filing * * *, when a claim has been filed within the statutory period, an amendment thereof may be allowed after the expiration of the time for filing." See In re Weco Equipment, Inc., D.C.E.D.N.Y., 55 F.Supp. 532, affd. as Public Operating Corporation vs Schneider, 2 Cir., 145 F.2d 830, where the facts were quite similar to those at bar. See also In re Casey, D.C.S.D.N.Y., 53 F.Supp. 879.

The long, and never satisfactorily explained, delay in the filing of this claim is bitterly assailed by the Debtor and by Ferend and the Debtor's subsidiary, Swordlines, Inc., as creditors. And it is urged that the claim itself actually makes no distinction between alleged services to Marine Maintenance prior to the Chapter Ten petition and those services alleged to have been rendered during the reorganization proceedings. The question of the merits, if any, of the Granik claim is not before us and we have no opinion thereon. We merely hold that the claim has been filed.

In No. 9894, the order of the District Court dated December 15, 1948, in allowing $10,000 as compensation for services to appellant-trustee in addition to the sum of $15,000 previously allowed, will be affirmed. That part of the order of the District Court dated January 5, 1949, which sustains exceptions (2) and (3) filed by Debtor to the final account of appellant-trustee, and fixing surcharges against the Trustee with respect to the second exception in the sum of $1,340.08 and with respect to the third exception in the sum of $1,725.00 will be reversed. The order dated January 5, 1949, amending the aforesaid order of December 15, 1948, and providing for the deduction of $3,065.08 (the aggregate of the surcharges above mentioned) from the final allowance of $10,000 to appellant-trustee will be reversed.

In Nos. 9911 and 9930, that part of the order of the District Court dated January 5, 1949, which dismissed certain exceptions to the Trustee's account will be affirmed.

In No. 9968, the order of the District Court of March 28, 1949, disallowing the proof of claim of Theodore Granik will be reversed.

Judge O'Connell heard the argument and participated in the consideration of these cases but died before the opinion was filed.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

IN THE

Supreme Court of the United States

October Term—1949

No. 143

MARINE MAINTENANCE CORPORATION,

Petitioner,

vs.

EDWARD R. McGLYNN, as Trustee in proceedings for reorganization of debtor,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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The state of facts in the petition filed in this matter substantially sets forth the factual situation.

The decision below is correct. It turns on the peculiar facts and circumstances of the case which were in effect, found by the District Court and approved by the Circuit Court of Appeals, and does not present a question of general importance. There is no conflict of authority.

It will be noted that although there were four separate appeals considered by the Circuit Court, the petition only involves one. The amount involved is $3,065.08. The District Court in its memorandum filed December 15, 1948 (see Volume I, Appendix pp. 123a and 124a), found as a fact in connection with the second exception which involves $1,340.08:

> "This exception is directed to certain sums paid by the Trustee to one William J. Manning, an employee. It is admitted by the Trustee that these sums were paid to reimburse the said employee for expenses incurred and paid by him in the discharge of his duties. It appears that weekly payments in the total of $1,340.08 were thus paid without supporting vouchers or receipts. This exception will, therefore, be sustained and the Trustee will be surcharged the full amount of this expenditure. This is not to suggest that this expense was not necessarily incurred by the Trustee in the discharge of his duties, but the Court is reluctant to lend its approval to what was obviously a bad accounting practice."

With reference to the third exception, it found,

> "The third exception is directed to rents in the total amount of $1,725.00, for office space occupied by the Debtor during the period of reorganization, but formerly occupied by the Trustee. It is admitted that a monthly rental of $50.00 was paid to Albert Greenfield & Co., for this space, which was apparently released by the Trustee. The only explanation of the Trustee is that no other space was readily available during the years 1944, 1945 and 1946, and we accept this explanation as true because we know that office space was at a premium during this period. The expenditure may have been necessary, but it is our opinion that it should not have been made without first acquainting the Court with the necessity of making it and obtaining the Court's approval. This exception is, therefore, sustained, and the Trustee will be surcharged the amount of $1,725.00."

The William J. Manning referred to in Exception No. 2 and the particulars referred to above, was respondent's chief bookkeeper and accountant from almost the beginning of this proceeding until June, 1945. He had complete supervision over the entire staff of bookkeepers and accountants, which ranged from one to ten in number. It

was necessary for him to confer almost daily with representatives of the F. B. I., which organization made a complete check of debtor's records similar to that conducted under respondent's supervision, and with numerous Field Agents and representatives of the United States Maritime Commission. In the beginning of this proceeding practically all of the records of the debtor were in the possession of the Department of Justice in its New York office and later transferred to the Federal Building in Newark. After the criminal trial and pending the appeal taken from the conviction of the debtor's treasurer the records were impounded by the Court in the Federal Building in Newark. This required almost daily traveling back and forth from Newark to the New York office of the Department of Justice and later to the Federal Building in Newark by some member or members of the respondent's bookkeeping staff. During the trial of the criminal case in Newark it was necessary to have some of the accounting staff located in a hotel in Newark because a great deal of work had to be done early in the morning before the District Court opened and late in the afternoon and evening after the Court had adjourned. Later many trips were necessary to both Philadelphia and Washington by Manning as respondent's representative.

Every week Manning prepared a statement of the cash expenses paid by him in connection with his duties which were submitted to the respondent and approved for payment. Every one of these weekly requisitions was introduced in evidence. It was impossible to obtain supporting vouchers for many of such expenses. Those are the items in Exception No. 2 which were labeled by the debtor exception as "Unsupported according to good accounting practice."

Exception No. 3 deals with an expenditure by respondent for monthly rent of $50.00 for space in his office exclusively used and occupied by persons in his employ as

trustee, or Government representatives who found it necessary to spend considerable time to check debtor's records and to approve claims which were later allowed and paid in the substantial sums set forth in the statement part of this brief.

These monthly payments were made directly to the Renting Agent of the building. At the time of respondent's appointment attempts were made to procure office space but it is a matter of judicial notice that at that particular time office space was almost impossible to procure in Newark. Respondent had some vacant space in his office because one of his associates who used it was in the armed services and it was charged at exactly the same rate per square foot as respondent paid for his entire suite.

Respondent admits that the District Court had the power to review respondent's account as Trustee and to surcharge him if the proper factual situations were indicated by the proofs. See 11 U. S. C. A., Sec. 75, and cases therein cited. Particularly see Note 45, page 343. Also see 11 U. S. C. A., Sec. 641, Note 27 on page 437.

But as was said in the case of *Chappel* v. *First Trust Company of Appleton, Wis.*, in 30 F. Supp. 765 (D. C. Wis., 1940) at page 766:

> "His accounts may be surcharged for any loss that his wrongful conduct may have occasioned."

In re B. A. Montgomery & Son, 17 F. 2d 404 (D. C. Ohio, 1927), at page 405:

> "If in the performance of these duties he violates the law or acts so negligently or carelessly as to inflict loss upon the estate or persons interested therein, he must answer in damages."

See also *Carson, Pirie, Scott & Co.* v. *Turner,* 61 F. 2d 693 (C. C. A. 6th, 1932).

The head note *In re Moorehead Knitting Co.*, 58 F. Supp. 88 (D. C. Pa., 1944) reads:

> "In the absence of proof of unfaithfulness, fraud, fraudulent intent, or loss, no surcharge can be maintained against trustee in corporate reorganization proceeding."

Judge BUFFINGTON in this Circuit said *In re Eberhardt*, 3 F. 2d 990 (C. C. A. 3rd, 1925) at page 991:

> "* * * failure to discern any act or failure to act on the part of the receiver in the premises which is a proper subject of criticism, we are of the opinion that the possibility of surcharge of accountant is too remote for consideration, * * *."

In connection with some of the items in Exception No. 2, it is quite evident that respondent's bookkeeper took advantage of respondent by including alleged disbursements which, apparently, were not made by the bookkeeper. However, respondent exercised due diligence in the employment of this bookkeeper and, therefore, the Court's attention is directed to *Evans* v. *Williams*, 276 F. 650 (C. C. A. 6th, 1921) and *In re Northern Marble Corp.*, 51 F. Supp. 26 (D. C. Del., 1943) which upholds the principle that if the trustee exercised due diligence in the employment of competent employees upon whom he was reasonably entitled to rely, he should not be held responsible for results created by such employees who turned out to be careless or who actually deceived him.

Conclusion

It is respectfully submitted that an examination of the cases cited by petitioner in its brief will disclose that where surcharges were upheld the factual situation involved the person who was surcharged with something more than carelessness or negligence and in most every case there

was some wrongful conduct which amounted to unfaithfulness, fraud, or fraudulent intent, and in each instance a loss to the estate. The conduct of respondent in this case did not amount to unfaithfulness, fraud or fraudulent intent and there was no loss to the estate.

The petition should be denied.

Respectfully submitted,

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